STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
JAMES AND JANE COURTIEN	:	ORDER DTA NO. 818053
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 1994 and 1995.	:	

Petitioners, James and Jane Courtien, 308 Woodland Drive, Brightwaters, New York 11718-1925, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 1994 and 1995.

A small claims hearing was held before James Hoefer, Presiding Officer, at the offices of the Division of Tax Appeals, State Office Building, Veterans Memorial Highway, Hauppauge, New York, on November 30, 2001 at 10:45 A.M. Petitioners appeared by Lazer, Aptheker, Feldman, Rosella & Yedid, P.C. (Steven B. Aptheker, Esq., of counsel). The Division of Taxation appeared by Barbara G. Billet, Esq. (Philip Sanfedele).

Presiding Officer Hoefer issued a determination on April 18, 2002 which granted the petition of James and Jane Courtien in part and directed the recomputation of the Notice of Deficiency dated December 18, 1998.

On May 16, 2002, petitioners, appearing by their representative, Lazer, Aptheker, Feldman, Rosella & Yedid, P.C. (Steven B. Aptheker, Esq., of counsel), filed an application for administrative costs pursuant to Tax Law § 3030. The Division of Taxation, appearing by Barbara G. Billett, Esq. (Peter B. Ostwald, Esq., of counsel), filed a motion in opposition and a

memorandum of law on June 19, 2002. Petitioners filed reply affidavits which were received on July 2, 2002, which date began the 90-day period for issuance of this order.

Based upon petitioners' application, the Division's motion in opposition, petitioners' reply affidavits, the small claims determination and all pleadings and documents submitted in connection with this matter, Winifred M. Maloney, Administrative Law Judge, renders the following order.

ISSUE

Whether petitioners are entitled to an award of costs pursuant to Tax Law § 3030.

FINDINGS OF FACT

1. For the two years at issue in this proceeding, petitioner Jane Courtien[1] was president and sole shareholder of Courtien Communications Ltd. ("the corporation"), an entity which was incorporated in New York State on March 1, 1989 and which elected to be treated as an S corporation. The corporation was engaged in the communications consulting business, primarily involved in the review of telephone bills of large corporations to determine if said corporations had been overbilled.

2. On or about September 23, 1996, the Division commenced a withholding tax audit of the corporation for the period January 1, 1993 through June 5, 1996. As the result of its withholding tax audit, the Division, on March 24, 1997, issued four notices of deficiency to the corporation on the grounds that the compensation it had paid to petitioner should have been treated as wages, and that it had improperly failed to withhold any New York State income taxes

[1] Petitioner James Courtien is involved in this proceeding solely as the result of having filed joint personal income tax returns with his spouse. Accordingly, the use of the term petitioner will, unless otherwise noted, hereinafter refer solely to Jane Courtien.

from said wage compensation. The notices for the years 1993, 1994 and 1995 asserted that penalties and interest were due, while the notice for the period January 1, 1996 through June 5, 1996 asserted that $6,200.00 of tax was due together with penalties and interest.

3. The corporation contested the four notices dated March 24, 1997 by filing a Request for Conciliation Conference with the Bureau of Conciliation and Mediation Services ("BCMS"). A conciliation conference was held by BCMS and, pursuant to a letter dated March 17, 1998, the conciliation conferee advised the corporation's representative that "[F]or purposes of resolving the matter, I am proposing to modify the Notice of Deficiency" as issued by the Division. A Consent enclosed with the March 17, 1998 letter provided that the penalties asserted for all four years were canceled and that the $6,200.00 of tax asserted for the period January 1, 1996 through June 5, 1996 was canceled. The Consent also provided that interest of $970.09, $731.18, $2,045.44 and $1,767.59 was due for 1993, 1994, 1995 and 1996, respectively. On March 30, 1998, petitioner, on behalf of the corporation, executed the Consent agreeing to the final disposition of the four notices of deficiency as proposed by the conciliation conferee.

4. Petitioner and her spouse timely filed joint New York State personal income tax returns for the years 1994 and 1995 reporting thereon, *inter alia*, income or loss from the corporation, which amounts were passed through to petitioner, and business income reported on Federal Schedule C. The corporation's Federal income tax returns, filed on Form 1120S, reported an ordinary loss of $19,454.00 for 1994 and ordinary income of $15,028.00 for 1995, which amounts were carried over to petitioner's New York State personal income tax returns for the two years at issue and were utilized in computing petitioner's taxable income for said years.

5. The cost of goods sold as reported by the corporation on Federal Form 1120S represented amounts paid to petitioner and other individuals which were reported as

nonemployee compensation on Federal Form 1099-MISC. The corporation issued forms 1099-MISC to petitioner reporting that she had received nonemployee compensation of $89,763.00 for 1994 and $209,033.91 for 1995. Petitioner reported the nonemployee compensation shown on Federal forms 1099-MISC as gross receipts on Federal Schedule C, Profit or Loss From Business. The following represents the amounts reported by petitioner on Federal Schedule C for the years 1994 and 1995:

	1994	**1995**
Gross income	$89,763.00	$209,034.00
Less expenses:		
Car and truck	10,656.00	9,076.00
Insurance	-0-	1,740.00
Legal	-0-	150.00
Office	835.00	6,424.00
Supplies	-0-	290.00
Travel	19,503.00	28,140.00
Meals and entertainment	3,988.00	4,599.00
Utilities	-0-	1,240.00
Gifts	2,664.00	3,043.00
Postage	-0-	332.00
Telephone	-0-	5,242.00
Mailing costs	-0-	20,000.00
Net profit	$52,208.00	$128,758.00

6. On February 5, 1997, petitioner's personal income tax returns for the years 1994 and 1995 were assigned to the Division's Nassau District Office for audit. Although the withholding tax audit of the corporation was also performed by the Nassau District Office, the audit of

petitioner's personal income tax returns was assigned to a different auditor. The first notation in the auditor's log was made on March 7, 1997 and stated "Discussed case with T/L [team leader]. Will check Schedule C expenses and if documented will revise to Schedule A treatment as another exam determined that T/P's were employees and not Schedule C filers."

7. The audit of petitioner's personal income tax returns for 1994 and 1995 continued over the next year and on April 1, 1998, one day after petitioner signed the Consent settling the corporation's withholding tax audit, the auditor made the following notation in his log:

> Called rep as T/P's corporation did not prevail in BCMS proceeding on withholding taxes. Informed rep that, as stated in my 2/26/98 letter, I will have to disallow the Schedule C format due to this result and that Schedule C expenses deducted would have to be reclassified as Miscellaneous Itemized Deductions.

8. On December 18, 1998, the Division issued a Notice of Deficiency to petitioner and her spouse asserting that $1,783.26 and $6,865.31 of additional New York State personal income tax was due for the years 1994 and 1995, respectively, together with interest. The additional tax due for each year at issue was based on reclassifying petitioner's compensation from the corporation as wages, disallowing the adjustment to income for ½ of self employment tax and requiring the Schedule C expenses to be claimed as miscellaneous itemized deductions. The Division also did not allow a portion of the expenses claimed on Schedule C to be carried over as miscellaneous itemized deductions on the basis that these expenses were unsubstantiated. Specifically, the Division's audit increased petitioner's reported taxable income by $22,631.00 and $86,159.75 for the years 1994 and 1995, respectively.

9. In response to the Notice of Deficiency, petitioner filed a Request for Conciliation Conference with BCMS. Following a conciliation conference on February 1, 2000, BCMS issued a conciliation order on June 30, 2000 which sustained the Notice of Deficiency.

10. On September 28, 2000, petitioner filed a petition with the Division of Tax Appeals in protest of the Notice of Deficiency.

11. A small claims hearing before a presiding officer was held on November 30, 2001, with all briefs to be submitted by January 18, 2002. On April 18, 2002, the presiding officer issued a determination which granted the petition in part and directed the Division to recompute the Notice of Deficiency consistent with the determination. In reaching his conclusion the presiding officer found that the Division was not precluded by the doctrines of *res judicata* and collateral estoppel from raising the issue of how petitioner's income should be reported on her personal tax returns. He held that the Consent form executed by petitioner settling the withholding tax audit of the corporation is a form used by BCMS to settle a dispute where there is no need to issue a conciliation order. The presiding officer concluded that like a conciliation order, the Consent cannot be considered as precedent or given any force or effect in subsequent proceedings brought by the taxpayer or in any other proceeding. He further found that the Division properly determined that petitioner was an employee of the corporation for the years at issue. The presiding officer held that petitioner failed to produce any documentary or other credible evidence to support the expenses which were disallowed on audit as unsubstantiated. The presiding officer also determined that, since petitioner was the sole employee and only shareholder of the corporation, it was fair and equitable (Tax Law § 2012) to adjust the amount of income or loss which petitioner reported on her personal income tax return as a pass through from the corporation. Specifically, he directed the Division to incorporate the Schedule C deductions which it found to be substantiated for 1994 and 1995 into the computation of income or loss received from the corporation, rather than treating those deductions as miscellaneous itemized deductions subject to the 2% of adjusted gross income limitation. He further directed

the Division to increase petitioner's 1994 tax year reported pass through loss from the corporation by the sum of $3,689.00, which amount represents the employer's share of the social security taxes. For the 1995 tax year, in addition to subtracting the substantiated Schedule C deductions, the presiding officer also directed the Division to subtract the sum of $4,694.00 (for the employer's share of social security taxes) and $19,300.00 (for amounts which could have been paid to a pension plan or defined benefit plan) from petitioner's reported pass through income from the corporation. The presiding officer recognized that the above adjustments would impact the computation of adjusted gross income for both years and directed the Division to make any necessary modifications to the audit adjustments that it had made to medical expenses, rental loss and the New York itemized deduction adjustment.

12. On May 16, 2002, petitioners filed an application for reasonable administrative costs pursuant to Tax Law § 3030. Petitioners' application contains petitioner Jane Courtien's sworn statement that petitioners have paid their representatives, the law firm of Lazer, Aptheker, Feldman, Rosella & Yedid, P.C., all fees and expenses incurred in connection with this proceeding and they are seeking reimbursement of administrative costs in the amount of $1,807.07.

13. To document their claimed administrative costs, petitioners submitted with their application the affidavit of Steven B. Aptheker, Esq., a member of the law firm of Lazer, Aptheker, Feldman, Rosella & Yedid, P.C. The law firm spent a total of 24 hours working on this matter. Mr. Aptheker personally attended the conciliation conference and the small claims hearing and had numerous conversations with petitioner concerning this matter. In addition, other attorneys with the firm prepared the petition and drafted correspondence to the Division of Tax Appeals addressing the issues raised in the appeal. Mr. Aptheker claims that the amount of

time spent on this matter was reasonable in light of the issues raised. Attached to Mr. Aptheker's affidavit is a two-page itemized "Detail Transaction File List" prepared by the law firm, showing the actual time expended, the hourly charges thereof, the other disbursements which such firm charged in connection with its representation of petitioners in this matter and payments received from petitioners. As set forth in the Detail Transaction File List, a total of 24.00 hours was expended on this matter resulting in legal fees totaling $5,080.50. Review of the two-page itemization reveals that the firm's attorneys who handled this matter billed at rates which varied from $150.00 per hour to $400.00 per hour. In addition, disbursements in this matter incurred by the firm totaled $7.07, consisting of postage and telephone costs. Based on the statutory rate of $75.00 per hour, petitioners are seeking reimbursement of fees incurred for legal services in the amount of $1,800.00. In addition to legal fees, petitioners are seeking reimbursement of costs and expenses incurred in the amount of $7.07. According to the Detail Transaction File List, the legal fees and costs were incurred between January 5, 2000 through January 10, 2002, which time frame corresponds to the time period shortly before the conciliation conference through the time of the firm's finalization of petitioners' reply letter submitted to the presiding officer.

14. Petitioners premise their claim for fees and costs on the position that they "substantially prevailed with respect to the amount in controversy." Petitioners' representative argues that, based upon the presiding officer's determination, the amount now owed by petitioners is significantly less than that originally assessed in the Notice of Deficiency.

15. The Division filed a motion to dismiss the application. The Division argues that petitioners do not qualify as the prevailing party because their application fails to even mention whether their net worth did not exceed $2,000,000.00 at the time the petition was filed, nor did

petitioners' provide any statement in Ms. Courtien's affidavit regarding their net worth. The Division further argues that even if petitioners are found to be the prevailing party in these proceedings, they should not be allowed to recover costs because the Division's position was substantially justified. On July 2, 2002 petitioner filed reply affidavits in response to the Division's motion in opposition.

16. In her reply affidavit, petitioner states that she and her husband have a total net worth that does not now or at the time the action was filed exceed two million dollars.

17. In his reply affidavit, Mr. Aptheker argues that petitioners are not claiming entitlement to costs based on the unreasonableness of the Commissioner's position but on the fact that petitioners "substantially prevailed with respect to the amount in controversy." He further contends that even if the Commissioner's position was justified and reasonable, the tax liability eventually imposed on petitioners was a small percentage of the amount originally demanded in the Notice of Deficiency that was the subject of petitioners' appeal. With respect to petitioners' net worth, Mr. Aptheker contends that equity dictates that the absence of a sworn statement regarding petitioners' net worth from the original application should not be determinative where the oversight was promptly addressed and cured.

CONCLUSIONS OF LAW

A. In 1997, the New York State Legislature added Tax Law § 3030 to Article 30 of the Tax Law, which is cited as the "Taxpayer's Bill of Rights" (L 1997, § 31, eff Sept. 10, 1997). Section 3030 is modeled on section 7430 of the Internal Revenue Code, also known as the Federal Taxpayers Bill of Rights (***see***, Legislative Memorandum, McKinney's Session Laws, p. 2549). As pertinent here, Tax Law § 3030(a) provides that, in any administrative proceeding which is brought by the Commissioner of Taxation and Finance ("Commissioner") in connection

with the determination of any tax, the prevailing party may be awarded a judgment or settlement where (1) the taxpayer is the prevailing party (Tax Law § 3030[a]); (2) the fees are for administrative costs allocable to New York State and not to any other party (Tax Law § 3030[b][2]); (3) the taxpayer did not unreasonably protract the administrative proceeding (Tax Law § 3030[b][3]); and the costs claimed are reasonable (Tax Law § 3030[a]).

"Prevailing party" is defined by Tax Law § 3030(c)(5)(A) as any party (other than the Commissioner or a creditor of the taxpayer)

> (i) who (I) has substantially prevailed with respect to the amount in controversy, or (II) has substantially prevailed with respect to the most significant issue or set of issues presented, and
>
> (ii) who (I) within thirty days of final judgment in the action, submits to the court an application for fees and other expenses which shows that the party is a prevailing party and is eligible to receive an award under [section 3030], and the amount sought, including an itemized statement from an attorney or expert witness representing or appearing on behalf of the party stating the actual time expended and the rate at which fees and other expenses were computed (except to the extent differing procedures are established by rule of court), and (II) is an individual whose net worth did not exceed two million dollars at the time the civil action was filed. . . . (Tax Law § 3030[c][5][A]).

Tax Law § 3030(c)(5)(C) provides:

> Any determination under this paragraph as to whether a party is a prevailing party shall be made by agreement of the parties or
>
> (i) in the case where the final determination with respect to tax is made at the administrative level, by the division of tax appeals, or
>
> (ii) in the case where such final determination is made by a court, the court.

B. The first issue to be resolved is whether petitioners are the "prevailing party" with respect to the administrative proceeding to which this application for costs applies. Petitioners

filed an application for costs on May 16, 2002, 28 days after the Determination became final.[2] Tax Law § 3030(c)(5)(A)(ii)(I) provides that an application for costs may be submitted to a court. There are no provisions for submitting such an application to the Division of Tax Appeals. However, since section 3030(c)(5)(C) extends jurisdiction to the Division of Tax Appeals to determine whether a party is a prevailing party, it may be concluded that petitioners' application for costs was properly filed with the Division of Tax Appeals.

The Determination of Presiding Officer Hoefer, attached to the application shows that petitioners substantially prevailed with respect to the amount in controversy; therefore, the requirements of Tax Law § 3030(c)(5)(A)(i)(I) were satisfied. The application requested the sum of $1,807.07, and included an itemized statement from petitioners' representatives setting forth the amount of time expended, the rate charged per hour and expenses incurred in pursuing this matter. Therefore petitioners have met the requirements of Tax Law § 3030(c)(5)(A)(ii)(I).

C. The application did not include a statement asserting that petitioners' net worth was less than $2,000,000.00 at the time the application was filed. This omission was noted by the Division in its response to petitioners' application. Thereafter, petitioners filed a reply affidavit which provided the information omitted in the original filing. I find that petitioners may supplement their application for costs and that they have fulfilled the statutory requirement to show that they were individuals whose net worth was less than $2,000,000.00 when the proceeding commenced (Tax Law § 3030[c][5][A][ii][II]). I conclude that Tax Law § 3030(c)(5)(A)(ii)(II) does not require that an applicant submit a net worth statement with his or her application for costs. The statute states that a "prevailing party" is any party "(ii) who . . .

[2] The small claims determination became final on the date it was issued since such determinations are not subject to any further review (Tax Law § 2012).

(II) *is* an individual whose net worth did not exceed two million dollars at the time the civil action was filed" (emphasis added). There would be no need to sub-divide Tax Law § 3030(c)(5)(A)(ii) into sub-parts I and II if the intention was to read the net worth requirement as though it were an integral part of the application for costs rather than an additional requirement for being deemed a prevailing party. The language of Tax Law § 3030(c)(5)(A)(ii)(II) does not require that an individual make a showing of his or her net worth with the application for costs. Petitioner's sworn reply affidavit that she and her husband meet the net worth requirement fulfills the criteria (***see, Avancena v. Commissioner***, 63 TCM 3133; Treas Reg § 301.7430-2[c][3][ii][A]).

D. As amended by the inclusion of the supplemental affidavit of petitioner, petitioners' application for costs establishes that they are "the prevailing party." The Division argues that even if petitioners are "the prevailing party" in this case, they are not entitled to recover administrative costs because the Commissioner's position in the administrative proceeding was substantially justified within the meaning of Tax Law § 3030(c)(5)(B). I agree and deny petitioners' motion for administrative costs for the following reasons.

Tax Law § 3030 is clearly modeled after Internal Revenue Code § 7430. Therefore, it is proper to use Federal cases for guidance in analyzing this state law (***see, Matter of Levin v. Gallman***, 42 NY2d 32, 396 NYS2d 623; ***Matter of Sener***, Tax Appeals Tribunal, May 6, 1988).

Federal case law holds that a position is substantially justified if it has a reasonable basis in both fact and law (***see, Information Resources, Inc. v. United States***, 996 F2d 780, 785).

For purposes of administrative costs, the position of the Commissioner is that taken "as of the date of the notice of deficiency, notice of determination or other document giving rise to the taxpayer's right to a hearing" (Tax Law § 3030[c][8][B]).

E. In this case, as a result of a withholding tax audit of the corporation, the Division issued four notices of deficiency to the corporation on the grounds that the compensation that it had paid to petitioner, the corporation's president and sole shareholder, should have been treated as wages, and that it had improperly failed to withhold any New York State income taxes from said wage compensation. Tax Law § 671(a)(1) requires every employer maintaining an office or transacting business in the State and making payment of any taxable wages to a resident or nonresident, to deduct and withhold a tax in the amount substantially equal to the tax reasonably estimated to be due from the employee's New York adjusted gross income or New York source income received during the calendar year. The method of determining the amount to be withheld is prescribed by regulations issued by the Commissioner (***see***, 20 NYCRR 171, et seq.). For purposes of this provision, the definition of employer and employee as set forth in the Internal Revenue Code and its applicable regulations apply for New York State personal income tax purposes (20 NYCRR 171.1[b]). Internal Revenue Code § 3121(d)(1)) expressly provides that the term "employee" means "any officer of a corporation." The Division's position at the time of the issuance of the notices to the corporation was based upon all available information, including Internal Revenue Code § 3121, which indicated that petitioner was an employee of the corporation and not an independent contractor, and thus was substantially justified. Moreover, in ***Matter of Imaging Management Services of America Inc.*** (Tax Appeals Tribunal, March 7, 2002), the Tribunal held that the corporation's president and sole shareholder was an employee pursuant to section 3121(d)(1) of the Internal Revenue

Code and that compensation it paid to said president, which compensation was reported via Federal Form 1099-MISC, constituted wages from which the appropriate taxes should have been deducted and withheld. The facts presented in the instant matter are indistinguishable from those present in ***Matter of Imaging Management Services of America Inc.*** (***supra***). Accordingly, I find that the Division's position that petitioner was an employee and not an independent contractor, was substantially justified as it has a reasonable basis in both fact and law (***see, Information Resources, Inc. v. United States***, 966 F2d 780, 785).

The notices for the years 1993, 1994 and 1995 asserted that penalties and interest were due, while the notice for the period January 1, 1996 through June 5, 1996 asserted that $6,200.00 of tax was due together with interest. After a conciliation conference, the conciliation conferee advised the corporation's representative that he was proposing to modify the "Notice of Deficiency" and enclosed a Consent which provided that the penalties asserted for all four years were canceled and the tax asserted for the period January 1, 1996 through June 5, 1996 was canceled. The Consent also provided that interest of $970.09, $731.18, $2,045.44 and $1,767.59 was due for 1993, 1994, 1995 and 1996, respectively. Petitioner, on behalf of the corporation, executed a Consent agreeing to the final disposition of the four notices of deficiency as proposed by the conciliation conferee. Subsequently, the Division issued a Notice of Deficiency to petitioners reflecting an increased New York State personal income tax liability for the years 1994 and 1995. The additional tax due for each year at issue was based on reclassifying petitioner's compensation from the corporation as wages, as consented to at BCMS. The Notice of Deficiency further reflected an adjustment of Schedule C expenses as miscellaneous itemized deductions, a portion of which were disallowed as unsubstantiated. Inasmuch as the Notice of Deficiency simply incorporated the adjustments

consented to at BCMS and were merely computational in nature, I find that the Division's position was substantially justified.

F. In the instant matter, petitioners argued that the doctrines of *res judicata* and collateral estoppel precluded the Division from raising the issue of whether petitioner is an independent contractor versus an employee of the corporation, where this exact same issue was raised, and subsequently settled by Consent in a previous audit of the corporation. In order to invoke this doctrine there must be an identity of issue which has necessarily been decided in the prior action and is decisive of the present action and there must have been a full and fair opportunity to contest the prior decision (***see, Staatsburg Water Co. v. Staatsburg Fire Dist.***, 72 NY2d 147, 531 NYS2d 876,878; ***Schwartz v. Public Adm'r of County of Bronx***, 24 NY2d 65, 298 NYS2d 955, 960). The party seeking the benefit of collateral estoppel must meet the burden of showing the identity of the issues in the present litigation and the prior determination (***Kaufman v. Eli Lilly & Co.*****,** 65 NY2d 449, 492 NYS2d 584, 588). The Consent executed by petitioner on behalf of the corporation concerned notices of deficiency issued based on the corporation's failure to withhold New York State tax on wages. The instant matter addresses the New York State personal income tax implications of the executed Consent. It is clear that there is no identity of issues between the corporate withholding tax action and the instant personal income tax proceeding. Absent a showing that specific factual issues had been litigated and necessarily decided in the previous proceeding and that those same issues are decisive in determining the outcome of the instant action collateral estoppel may not be invoked. Petitioners failed to carry their burden of proving that the doctrine of collateral

estoppel was applicable to refute the Notice of Deficiency. Consequently, the Division's position in issuing the Notice of Deficiency to petitioners was substantially justified.

In this case, the Division followed its guidelines in its issuance of the Notice of Deficiency. Its position in issuing the Notice of Deficiency was based on the Consent executed by petitioner on behalf of the corporation and the subsequent reclassification of corporate compensation as income to petitioner. As there is no identity of issues between the resolution of the previous matter by consent at BCMS and the determination in the present matter, the doctrines of *res judicata* and collateral estoppel may not be invoked. I find that the Division's position had a reasonable basis in both fact and law and therefore was substantially justified. Accordingly, petitioner may not be treated as the prevailing party for purposes of Tax Law § 3030 and therefore may not recover costs.

G. Petitioners' application for costs is denied.

DATED: Troy, New York
October 3, 2002

/s/ Winifred M. Maloney
ADMINISTRATIVE LAW JUDGE